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China, Peoples Republic of

HRI Food Service Sector

Hot Markets: Dining Destinations in Southwest China

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Report Highlights:

Less foreign competition, burgeoning demand, and passion for food make Southwest China's rapidly expanding hotel, restaurant, and institutional (HRI) sector a prime target for U.S. exports. The hotel sector and upscale stand-alone restaurants are the most promising markets for U.S. imports. Hotels and restaurants acquire many of their imported products from local distributors. The high-end part of the HRI sector uses imported products when the safety or quality of local products is in question, as well as to attract customers with unique, exotic imports as promotions.

Includes PSD Changes: No
Includes Trade Matrix: No
Annual Report
Chengdu ATO [CH5]
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I. Market summary

Southwest China: Rapid Growth and Import-Hungry Emerging City Markets

ATO Chengdu covers Southwest China, including Sichuan, Chongqing, Yunnan, and Guizhou provinces. One in every 33 people on earth lives in Southwest China. With a population of over 200 million and a regional gross domestic product (GDP) of \$290 billion in 2007, the area is over twice the size, six times the population, and three times the GDP of Central America. The economic growth the region is experiencing is raising incomes and increasing the market for foreign products. The region is also known for its passion for food. Consumers are keen to try imported products and are willing to pay a premium for a quality product. Chengdu's residents allocate the highest percentage of disposable income in the country on food away from home.

Economic growth and increased incomes are fueling increased expenditure on food and beverage sales. Growth rates in regional domestic product in the provinces of Southwest China are some of the highest in the world, averaging between 12.0 and 15.6 percent in 2007. Growth in the region's two largest emerging city markets (ECMs), Chengdu and Chongqing, reached 17 and 18 percent, respectively, in 2007. These two cities account for 20 percent of the region's population.

Rapid Growth in Value of Imports			
Province	Imports (million USD)		2006 Growth in Imports
	2005	2006	
Sichuan	499.26	662.11	32.62%
Chongqing	271.65	471.92	73.72%
Yunnan	137.23	239.66	74.64%
Guizhou	240.15	503.08	109.48%

Source: 2007 China Statistical Yearbook

By serving urban working households today, exporters gain exposure and experience necessary to stay relevant as incomes rise and consumer tastes evolve. Income and food expenditure are forecasted to continue to grow at a significant pace. McKinsey estimates that middle-income consumers now represent almost 35 percent of urban population, and at current growth rates will exceed 50 percent by 2010 and 70 percent of the total population by 2015. McKinsey also projects that urban food consumption projected will nearly fourfold from 2004-2025, an increase in value of \$427 billion China-wide.

SW China Dining Out Expenditures, Growth (millions 1993 USD)			
Province	2000	2007	2000-2007 % Increase
Sichuan	499.26	662.11	32.62%
Chongqing	271.65	471.92	73.72%
Yunnan	137.23	239.66	74.64%
Guizhou	240.15	503.08	109.48%

Source: Global Insight Regional Food Consumption

A Burning Hunger: Southwest China's Passion for Dining Out

The traditional food culture and robust economy has benefited the restaurant industry. Eating out is a tradition in southwest China, particularly in Sichuan society. Residents enjoy relaxing and sharing time and diverse foods with family, friends and business associates. It is common practice to

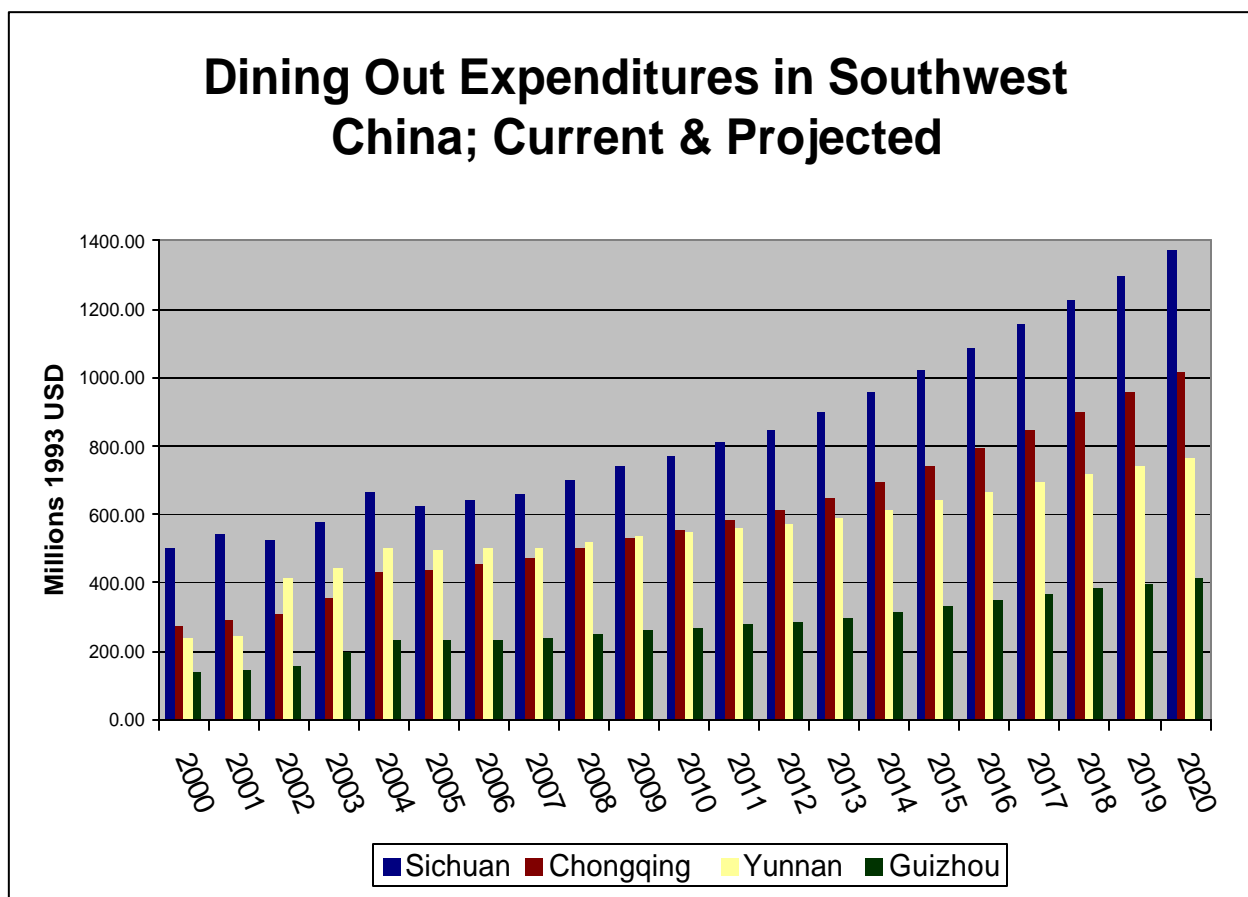
dine out in more upscale restaurants for special occasions like Valentine's Day, Chinese New Year, and even Christmas. Consumers are willing to pay a premium for quality and international dining experiences as their incomes rise. The booming economy continues to expand the economic roles of middle class and white-collar workers. The May 12, 2008 earthquake in Sichuan has increased many residents' passion for life and willingness to spend on quality-of-life products, including food.

SW China Tourism Revenue	
Province	2006 Revenues
Sichuan	\$470 million
Chongqing	\$468 million
Yunnan	\$147 million
Guizhou	\$87.7 million

Source: CH8401

Tourism and foreign investment have led to increased interest in foreign food cultures and imported products. There has been an increase in foreign food establishments outside international hotels, particularly in Chengdu and, to a lesser extent, Chongqing, the two largest emerging city markets in the region. As incomes have increased and tastes have been influenced by Western food culture, consumers are increasingly attentive to food safety and food nutrition.

Influenced by this trend, a "new Sichuan cuisine" has evolved from traditional Sichuan cuisine in recent years. The new cuisine puts increased emphasis on food nutrition and the inclusion of non-traditional and foreign ingredients. This has been a boon to western-style inputs, like dairy products, and imports, including imported meats and seafood. The "new Sichuan cuisine" not only challenges traditional Sichuan cuisine, it also impacts food consumption patterns throughout China.



Source: Global Insight Regional Food Consumption

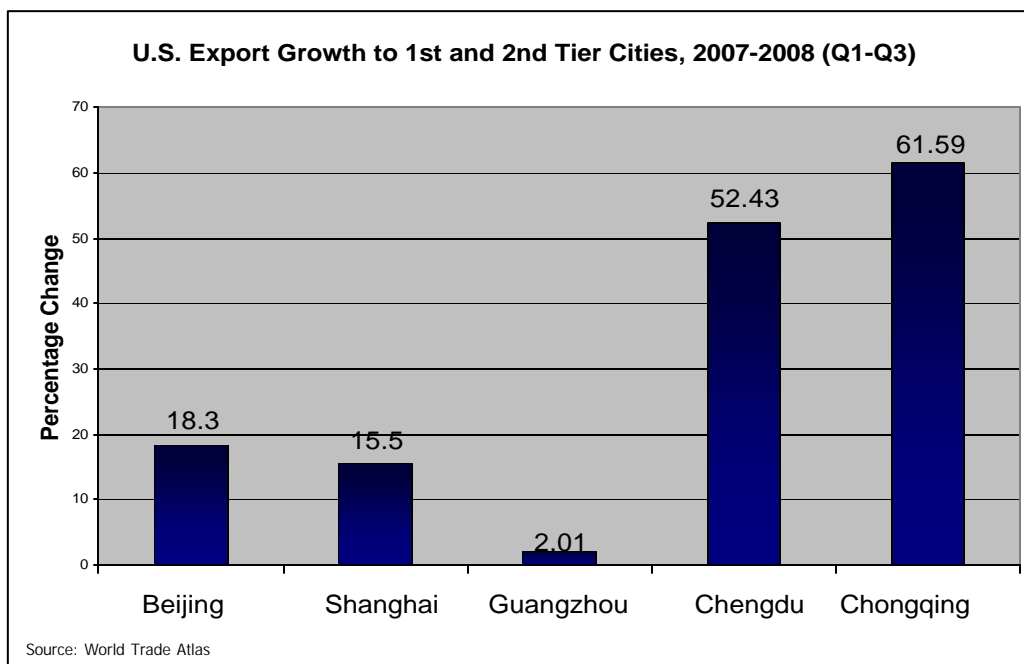
Chengdu & Chongqing: Emerging City Markets Ripe for Development

The markets of Southwest China are less saturated with imports than developed port cities, providing several advantages to marketing products in the region. There is less foreign competition despite burgeoning demand. Marketing dollars go further in the region because new imports face less foreign competition in Southwest China than in the saturated markets of the more developed port cities. Additionally, Sichuan food plays a leadership role in food trends. It is held in high esteem across China and influences both the national market and other regional markets.

2007 Disposable Income per Capita Growth Rate	
Sichuan	4.8%
Chongqing	5.3%
Yunnan	3.8%
Guizhou	3.8%

Source: Global Insight

Chengdu, the capital of Sichuan province, is the wealthiest and most advanced city in the region. Chengdu currently has the largest market for imported products in the HRI sector and the most developed hotel and restaurant sector. Chongqing is growing rapidly and is experiencing rapid expansion of its hotel sector, and it is only a few years behind Chengdu in terms of income level. Incomes in Kunming and Guiyang are less developed than in Chongqing and Chengdu, but provide significant opportunities as well.



Local Residents Turn to Hotel Restaurants for Prestige, Safety, and Convenience

The majority of customers in hotel restaurants are local residents as opposed to in-house guests. Food and beverage managers in Chongqing and Chengdu estimated that 70 to 90 percent of hotel restaurant clientele were local residents. Hotel restaurants are held in high esteem as high-end establishments. Hosts earn face (respect from their guests) by selecting a hotel restaurant as a dining venue. The food safety and quality associated with international hotel chains also attracts residents to hotel restaurants. Convenience is another motivating factor. Dining in the hotel restaurants saves time for business travelers at conferences. Hotel restaurants have benefitted from the increase in the number of outside business visitors as the Southwest emerging city markets continue on the path of rapid economic growth. Five-star hotels are also major landmarks that are easy to find, making them optimal places to meet.

Hotel Promotions Often Showcase Imported Products, Boost Restaurant Revenues

Food service makes up a significant portion—roughly one third—of hotel revenues in Southwest China. In 2006, food service accounted for \$197.9 million of Chengdu's total hotel revenue of \$567.2 million in 2006. Room revenue accounted for \$301 million.

Southwest China Hotel Revenue (2006)	
Province	Revenues
Sichuan	\$567.2million
Chongqing	\$321.9million
Yunnan	\$412.5million
Guizhou	\$147.7million



Chef Nora Dejoie's Thanksgiving hotel buffet planning seminar promoted American food culture and products.

Given the significance of food service revenues to hotels, short-term promotions are an important way for hotels to attract the attention of consumers. Successful promotions can boost hotel restaurant traffic significantly. Five-star hotels are constantly working to differentiate themselves from their competition. Promotions often feature foreign guest chefs and luxury food and beverage products, which are often imports. Holidays, like Christmas and Thanksgiving where 400 RMB per plate meals sell out, are common times for promotions. Examples of other recent promotions in Chongqing and Chengdu are Alaskan king crab legs, brandy and wine tastings, French and American food festivals, and Kobe beef.

Chengdu's International Hotels Raising the Bar for Local Competitors

Chengdu's robust economy and international exposure set the stage for a large expansion in the hotel industry. The number of international 5-star hotels has more than doubled in the last 5 years and includes Starwood Hotels and Resorts Worldwide, Inc., Intercontinental Hotel Group, ACCOR Group and Shangri-la Group. The increased number of international hotels in Chengdu has expanded the opportunities for U.S food products. Large numbers of sophisticated business travelers and tourists expect top-quality food and service, with a spicy Sichuan twist.

In addition to the international hotel chains, Chengdu also has several regionally-known 4- and 5-star hotels including the Jingjiang Hotel and the Minshan Hotel. Increased competition from their international counterparts has pushed local brands to upgrade hotel management, hotel facilities, and food service. Service and food quality have also improved drastically.



Café Z at the Chengdu Shangri-La Hotel serves up local and international flavors

Projected Growth Fueling Expansion of Chongqing Hotel Sector

The hotel industry has taken note of Chongqing's rapid ascent. Hotel companies are racing to get a foot in the market before it is fully developed. Even though there are already several international five-star hotels in the market, there are plans in the next few years for a Kempinski, Westin, Shangri-la, second Hilton hotel, and two Sheraton hotels. Some food and beverage managers forecast that the market will mature significantly over the next two years. Tourism associated with Yangtze River cruises draws visitors to the city, and Chongqing is increasingly a business center as a government-designated special economic development zone.

High-End Restaurants the Largest Market for Imports in Restaurant Sector

The next largest market for agricultural imports in the HRI sector is stand-alone upscale restaurants. Chengdu has the most developed upscale restaurant sector in Southwest China. The markets in other cities are developing, particularly in Chongqing, but have not yet matured. As stand-alone fine dining restaurants become more prevalent and establish reputations for quality and safety, they will increasingly compete with hotel restaurants. In Chengdu, the majority of fine dining establishments specialize in Chinese cuisine; however, the number of international fine dining restaurants has been increasing in the past few years. Euromonitor International reports that in 2007 North American full-service restaurants saw the fastest growth in value of sales China-wide at 30 percent. The full-service restaurant sector is highly fragmented; chain restaurants only account for 5 percent of total sales.



McDonald's is one of the most dominant international QSR chains in SW China

Quick service restaurants (QSR) and chain restaurants have been rapidly expanding in Southwest China, but opportunities for imports are limited. Both foreign and Chinese QSR chains predominantly use domestic sources for their products to keep costs down. For example, an iconic deluxe hamburger sold by a popular U.S. chain contains only one imported product when sold in China— imported beef fat is added to the patties because the Chinese cattle are so lean. The two leading companies in the region are Yum! Brands Inc. and McDonalds. The Chengdu Economic Commission reported that in 2006 McDonalds and Yum! Brands Inc. generated \$25 million and \$11 million in revenue, respectively.

Low Cost Nature of Institutional Food Service a Challenge to Imports

Imports generally are not competitive and most caterers are unfamiliar with imported products. In general, the catering industry in the Southwest focuses on providing lunch box foods. Commodity pricing ranges from \$ 0.7 to \$1.39 per unit. Where imports are not the low cost input, the low price of catered products makes it difficult for imported products to compete. Further, most catering is performed by in-house service units. As a result, many catering services lack knowledge of and experience using imported products

The upscale catering industry in Chengdu is in the initial stages of development. Most five-star hotels and some high-end restaurants now offer off-site catering services targeted towards special occasions. The international business community, including companies like Intel, Motorola and Nokia, has reported using these nascent services.

Strong Growth Opportunities for Those Who Overcome Logistical Challenges

Consumers are interested in quality food products, and the local food culture promotes experimenting with new food products. Another asset is the reputation of U.S. products. They are held in high esteem for their quality and safety, and hotels and restaurants use this to their advantage to attract customers to their restaurants with promotions featuring U.S. imported products.

Key obstacles include logistics and fraudulent labeling of imported products. The distance from major port cities such as Shanghai and Shenzhen is a challenge for some U.S. imports.

Except for air transport, port to retail transportation time is from two to five days, and the cold chain is not always reliable.

Throughout China, fraudulent labeling in the retail sector is a problem, and Southwest China is no exception. Consumers are often not aware of how to determine if a food product marketed as U.S. imports are genuine. Intellectual property rights violations harm U.S. products' reputation for quality and safety and cuts into market share.

Market Entry into Southwest China	
Advantages	Challenges
Growing middle class: An estimated 35% of the 65 million urban residents in Southwest China are middle class or higher. This is projected to reach 50 percent by 2010.	Some consumers not educated about the superiority quality of certain imported products when local alternatives are available.
U.S. products valued for safety and quality	Strong local competition for fresh produce and some meat products
Sichuan cuisine sets trends for "Chinese" cuisine throughout all of China	Limited infrastructure and distribution , especially for perishable products; weak cold chain infrastructure
Interest in trying new food products	Geographical distance from port cities
Marketing dollars go further because of lower costs and less competition	IPR violations threaten product reputation
Hotel sector receptive to import promotions	Lack of importer and retailer knowledge and training in purchasing, handling, and merchandising U.S. products

II. Roadmap to Market Development

Getting Your Product to Market: Local Distributors, Importer-Direct, and Regional Distribution Centers

There are three main channels for distributing products to Southwest China: local distributors which purchase their product from port cities and then sell their products to retailers; regional distribution centers, normally associated with a single retailer chain; and importer direct, when retailers often working with a referred importer bring products directly from the port. Within the HRI sector, regional distribution centers are used primarily by QSR chains, such as Yum! Brands, Inc. and McDonalds, for purchasing and logistics. Importer-direct tends to happen for a few specialty or highly perishable products in the hotel sector, like some meats. Most imported meat is frozen.

Local Distributors are Primary Distributors in HRI Food Sector

The majority of imported products hotels and restaurants use are obtained through local distributors. Hotel food and beverage managers in Chengdu reported mostly using local distributors over importer-direct because product could be obtained more quickly from stocks held by local distributors. It is imperative to determine that the local distributors have good cold chain facilities and shipping practices to ensure that product quality is maintained during shipping. U.S. exporters must also make certain that distributors are familiar with proper

handling of unfamiliar imported products. Working with hotels for promotions is a good way to enter the market and establish a distributor supply chain for a product.

Introducing Your Product: Chengdu and Chongqing Hotel and Restaurant Distribution

Building close relationships with reliable distributors can also help exporters break into the hotel sector, as well as the high-end restaurant sector. Distribution networks in Chengdu appear to be more developed than in Chongqing. Hotel food and beverage managers in Chengdu reported that their local distributors had many products in stock, including wines. Post found that in Chongqing hotels would have to wait a three day minimum to acquire non-stocked products like maple syrup. Wines are not readily stocked in Chongqing by local distributors.

III. Differentiating U.S. Products from the Local Competition

Imported meats and produce face strong competition from domestically produced products. The Southwest provinces are major agricultural producers. Lack of dependable cold chain and the transport time from port cities is a major obstacle. The majority of fruits, vegetables, and meat products used by the HRI food sector are locally produced. U.S. wine faces competition from numerous European and Latin American wines already present in the market. Post found that Canada, Denmark, and Norway are aggressively promoting their seafood products in the Chongqing and Chengdu hotel sectors.

Selected U.S. Imported Products	Main Foreign Competitors
Red Meat	Canada, Denmark, New Zealand, Australia
Oranges	New Zealand, South Africa
California Table Grapes	Chile
Washington Apples	Chile, New Zealand
Cherries	New Zealand
Breakfast Cereal	United Kingdom, Australia, EU
Poultry	Thailand, Brazil
Cheese and Dairy	New Zealand, Australia, EU
Frozen Processed Products	Canada, New Zealand
Wine	Australia, France, Italy, Spain, Chile
Spaghetti sauce/tomato products	Italy, France, EU
Coffee	Japan, France, South Africa
Candy and Chocolate	Switzerland, Italy, France, Belgium, Japan
Nuts	Iran (pistachios), Mongolia, Korea (chestnuts) Russia
Ginseng	Canada, Korea
Premium Ice Cream	France, New Zealand
Seafood	Denmark, Canada, Russia, North Korea, Norway, Japan

IV. Select Best Product Prospects

Hotels and high end restaurants use imported products primarily because of food safety and quality concerns or to differentiate themselves from the competition with specialty items. When comparable local products are available, hotels are unlikely to use more expensive imported products. Interest in health, safety, and high-end gourmet products has increased with increased income levels. Consumers are becoming increasingly aware of foreign cuisines and high-end products and are often hungry to try them.

Post finds that these trends have led to opportunities for specific products. Luxury or specialty products are especially strong prospects when reliable distribution networks are established. Food promotions that focus on American regional cuisine are promising, as well as food and wine pairing events. Demand from the HRI sector for Western products such as spices, condiments, and cheeses is expanding rapidly and few local substitutes are available. Imported dairy products have increased in popularity due to the melamine dairy scandal, but U.S. dairy products face strong competition from New Zealand, Australia, and EU producers already in the market.

Select Products Present in the Market Which Have Good Sales Potential:

Poultry
Breakfast cereal
Cheese and dairy
Cherries
Seasoning products
Spaghetti sauce/tomato products
Candy and chocolate
Nuts
Lobster; other seafood
Dried fruit; especially prunes and raisins
Premium ice cream
Oranges
California table grapes
Washington apples

Select Products Not Present in Significant Quantities Which Have Good Sales Potential:

Red meat
Frozen processed products
Wine
Ginseng
Peanut butter, other specialty condiments
Oysters
Other poultry, including turkey and quail

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